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SUBURBAN MOBILITY AUTHORITY FOR REGIONAL TRANSPORTATION

82-7550

Financial Statements

June 30, 2004 and 2003

(With Independent Auditors' Report Thereon)

SUBURBAN MOBILITY AUTHORITY
FOR REGIONAL TRANSPORTATION

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KPMG LLP
Suite 1200
150 West Jefferson
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Independent Auditors' Report

The Board of Directors
Suburban Mobility Authority
for Regional Transportation:

We have audited the accompanying basic financial statements of Suburban Mobility Authority for Regional Transportation (SMART) as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of SMART's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits, contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our report dated November 24, 2003, we expressed an opinion on SMART's 2003 financial statements qualified for the pension liability and expense not being determined in accordance with accounting principles generally accepted in the United States of America. As described in note 10, SMART has changed its method of accounting for these items and restated its 2003 financial statements to conform with generally accepted accounting principles. Accordingly, our present opinion on the 2003 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SMART as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued a report dated November 30, 2004 on our consideration of SMART's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

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Our audits for the years ended June 30, 2004 and 2003 were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in note 3, table 1 for the years ended June 30, 2004 and 2003 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole for the years ended June 30, 2004 and 2003.

We have also previously audited, in accordance with generally accepted auditing standards, the general-purpose financial statements of SMART as of and for the years ended June 30, 2002, 2001, 2000, 1999, and 1998 (none of which is presented herein), and we expressed qualified opinions on those financial statements. The supplementary information included in note 3, table 1, related to SMART's 2002, 2001, 2000, 1999, and 1998 financial statements, was subjected to auditing procedures applied in the audits of those general-purpose financial statements and, in our opinion, is fairly stated in all material respects in relation to the general-purpose financial statements from which it has been derived.

The Management's Discussion and Analysis and the schedule of funding progress are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

November 30, 2004

Overview of the Financial Statements and Financial Analysis

The following discussion and analysis has been prepared by SMART's management and should be read in conjunction with the financial statements and related footnote disclosures by which it is qualified in its entirety. The discussion is intended to present an overview of SMART's financial performance for the years ended June 30, 2004 and 2003 and does not purport to make any statement regarding the future operations of the organization. While SMART is an instrumentality of the State of Michigan, it is not a component of the State as defined by the Governmental Accounting Standards Board (GASB).

The annual report consists of the statement of net assets, statement of revenues, expenses, and changes in net assets, and the statement of cash flows, prepared in accordance with GASB principles.

Financial Highlights – FY 2004

SMART's current assets increased by $7.6 million due primarily to a surplus of revenue over expense for the year (excluding depreciation on assets purchased with capital grants).

Noncurrent assets decreased from the prior year by $14.3 million due primarily to depreciation charges on buses and other equipment ($18.4 million) offset by the addition of $4.4 million in vehicles and related equipment.

Total liabilities decreased by $5.9 million due to the annual payments against the debt incurred for the purchase of 287 linehaul buses in FY 2001, 2002, and 2003.

Net assets decreased from $57.4 million at June 30, 2003 to $57.2 million at June 30, 2004.

Operating revenues increased by $0.4 million as the result of an increase in linehaul ridership of approximately 4%.

Total operating expenses before depreciation expense increased by $2.6 million as the result of inflation of approximately 3.8%.

Financial Highlights – FY 2003

SMART's current assets increased by $9.5 million due primarily to a surplus of revenue over expense for the year (excluding depreciation on assets purchased with capital grants).

Noncurrent assets increased over the prior year by $14.1 million due primarily to the purchase of 87 linehaul buses through a lease/purchase agreement with Gillig Corp. and the purchase of 56 community transit vehicles.

Total liabilities increased by $19.0 million, due almost entirely to the obligation incurred during the year for the purchase of 87 new linehaul buses.

Net assets increased from $52.0 million (as restated) at June 30, 2002 to $57.4 million at June 30, 2003.

Operating revenues decreased by $727,100 as the result of a decrease in advertising revenue and a decrease in special services.

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Total operating expenses before depreciation expense increased by $4.9 million as the result of a significant increase in claims and insurance expense ($3.2 million) and a decision to increase Community credits to municipalities by approximately $1 million. Community credits represent a return of millage revenue to local communities to support local transit services.

Statement of Net Assets

The statement of net assets includes all assets and liabilities. It is prepared using the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. Assets and liabilities are generally measured using current values. One exception is capital assets, which are stated at historical cost less an allowance for depreciation.

A summarization of SMART's assets, liabilities, and net assets at June 30, 2004, 2003, and 2002 follows:

		2004	2003 (As restated)	2002 (As restated)
Assets:				
Current assets	$	46.5	38.9	29.4
Noncurrent assets		101.6	115.9	101.8
Total assets	$	148.1	154.8	131.2
Liabilities:				
Current liabilities	$	38.2	36.8	32.8
Noncurrent liabilities		52.7	60.6	46.4
Total liabilities	$	90.9	97.4	79.2
Net assets:				
Invested in capital assets, net of related debt	$	41.4	48.8	52.1
Unrestricted		15.8	8.6	(0.1)
Total net assets	$	57.2	57.4	52.0

At June 30, 2004, total SMART assets were $148.1 million, compared to $154.8 million in fiscal year 2003 and $131.2 million in fiscal year 2002. SMART's largest asset is its investment in linehaul and community transit buses and related equipment, at $74.2 million, compared to $66.6 million in 2003 and $44.7 million in 2002. The balance of SMART's capital assets consists primarily of buildings and other equipment. Grants receivable increased from $9.1 million in FY 2003 to $19.9 million in FY 2004 due to the timing of grant collections related to the transportation funding reauthorization efforts of the U.S. Congress. $12.9 million of the $19.9 million in grants receivable was collected in the first four months of FY 2005. The materials and supplies inventory decreased from $3.4 million in FY 2003 to $2.5 million in FY 2004 as the result of the sale of obsolete parts for retired buses.

(Continued)

SMART's liabilities total $90.9 million at June 30, 2004, compared to $97.4 million in 2003 and $77.8 million in 2002. Long-term debt of $52.7 million consists of payments due under a lease/purchase agreement with Gillig Corp. for 287 linehaul buses. Accrued self-insurance increased from $10.7 million to $12.1 million as the result of the timing involved in settling claims. Self-insurance expense for FY 2004 decreased by $2.6 million.

Statement of Revenues, Expenses, and Changes in Net Assets

The statement of revenues, expenses, and changes in net assets presents the operating results of SMART, as well as the nonoperating revenues and expenses. Operating revenues consist primarily of fare box revenue from linehaul and community transit services. Advertising and other revenues are also included in this category.

SMART is also dependent on state, federal, and local operating assistance, as well as income from investment activities, which are prescribed by GASB as nonoperating revenues. Operating expenses, as well as capital contributions, need to be included.

A summary of SMART's revenues, expenses, and changes in net assets for the years ended June 30, 2004, 2003, and 2002 is as follows:

		2004	2003 (As restated)	2002 (As restated)
Operating revenue	$	9.2	8.8	9.5
Operating expenses before depreciation		94.1	91.2	86.0
Operating loss before depreciation		(84.9)	(82.4)	(76.5)
Depreciation expense		16.0	13.7	14.6
Total operating loss		(100.9)	(96.1)	(91.1)
Nonoperating revenues		96.6	94.2	75.4
Net loss before capital contributions		(4.3)	(1.9)	(15.7)
Capital contributions		4.1	7.3	9.6
Net gain (loss)		(0.2)	5.4	(6.1)
Net assets, beginning of the year		57.4	52.0	58.1
Net assets, end of the year	$	57.2	57.4	52.0

SMART's primary sources of revenue are federal, state, and local operating assistance, which are classified as nonoperating revenue. As the result of declining state operating assistance, SMART placed a ballot question before the electorate in August 2002 to increase the local property tax millage from 1/3 mill to 6/10 mill for the years 2003 to 2006. The increased millage was approved by participating communities in Wayne, Oakland, and Macomb counties.

(Continued)

Fringe benefits increased by $1.9 million due primarily to a 14% increase in hospitalization insurance expense. Contractual services increased by $1.0 million as the result of a new contract for bus shelter maintenance and a reduction in grant funding of several contractual employees. Depreciation expense increased by $2.3 million due to the addition of 75 new linehaul buses in FY 2004. The loss on retirement of assets of $2.4 million is related to the early retirement of linehaul buses which were not candidates for rehabilitation and were replaced with new buses.

Capital contributions consist primarily of federal and state grants for the purchase of replacement and new capital assets. Most of the funds are provided through a federal formula administered by the Federal Transportation Administration. Discretionary funds are also made available in most years. At SMART's discretion, a portion of the federal formula dollars can be used as an offset to preventive maintenance expense.

SUBURBAN MOBILITY AUTHORITY
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Balance Sheets

June 30, 2004 and 2003

Assets		**2004**	**2003 (As restated)**
Current assets:			
Cash and cash equivalents	$	18,576,490	20,593,637
Operating assistance due from State of Michigan		797,690	1,156,327
Accrued interest receivable		20,695	61,364
Grants receivable		19,889,584	9,126,664
Local contributions receivable		3,333,992	2,982,015
Other receivables		531,073	789,380
Materials and supplies inventory		2,474,756	3,375,851
Prepaid expenses		889,805	798,309
Total current assets		46,514,085	38,883,548
Capital assets, net		101,596,528	115,903,141
Total assets	$	148,110,613	154,786,689
Liabilities and Net Assets			
Current liabilities:			
Municipal and community credits payable	$	6,277,929	5,881,804
Amounts payable under purchase-of-service agreements		380,995	223,543
Accrued self-insurance		12,108,189	10,705,640
Payable to State of Michigan		9,248	85,579
Accounts payable and accrued expenses		5,733,590	6,878,373
Accrued interest payable		1,154,857	1,346,865
Current portion of notes payable		7,522,161	7,080,483
Accrued compensation		5,048,620	4,552,932
Total current liabilities		38,235,589	36,755,219
Net pension obligation		49,229	600,285
Notes payable, net of current portion		52,654,793	60,032,715
Total liabilities		90,939,611	97,388,219
Net assets:			
Invested in capital assets, net of related debt		41,419,574	48,789,943
Unrestricted		15,751,428	8,608,527
Total net assets		57,171,002	57,398,470
Total liabilities and net assets	$	148,110,613	154,786,689

See accompanying notes to financial statements.

SUBURBAN MOBILITY AUTHORITY
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2004 and 2003

		2004	2003 (As restated)
Operating revenues:			
Revenues from transit operation	$	9,233,136	8,821,241
Operating expenses before depreciation expense:			
Salaries and wages		40,452,460	39,391,899
Fringe benefits		21,451,535	19,577,008
Contractual services		6,457,265	5,578,350
Materials and supplies		9,230,564	8,229,810
Utilities		2,490,117	2,208,564
Claims and insurance		4,659,142	7,072,572
Purchased transportation		8,862,811	8,816,063
Miscellaneous expenses		500,826	327,539
Total operating expenses before depreciation expense		94,104,720	91,201,805
Operating loss before depreciation		(84,871,584)	(82,380,564)
Depreciation expense		15,985,992	13,714,094
Total operating loss		(100,857,576)	(96,094,658)
Nonoperating revenues (expenses):			
Federal operating and preventive maintenance assistance		15,250,612	15,618,430
State operating grants		39,227,799	38,566,284
Local contributions		47,625,635	46,242,794
Interest income		301,581	312,693
Interest expense		(3,465,243)	(3,343,450)
Loss on retirement of assets		(2,400,990)	(3,262,454)
Other income		726	24,520
Total nonoperating revenues, net		96,540,120	94,158,817
Change in net assets before capital contributions		(4,317,456)	(1,935,841)
Capital contributions		4,089,988	7,379,395
Change in net assets		(227,468)	5,443,554
Net assets, beginning of the year, as restated (note 10)		57,398,470	51,954,916
Net assets, end of the year	$	57,171,002	57,398,470

See accompanying notes to financial statements.

SUBURBAN MOBILITY AUTHORITY
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Statements of Cash Flows

Years ended June 30, 2004 and 2003

	2004	2003 (As restated)
Cash flows from operating activities:		
Receipts from transit operations	$ 9,676,230	8,961,174
Payments for salaries and wages and fringe benefits	(61,959,363)	(59,268,026)
Payments to suppliers	(18,520,312)	(16,846,907)
Payments for claims and insurance	(3,256,593)	(6,805,531)
Payments for purchased transportation	(8,705,359)	(8,802,439)
Net cash used in operating activities	(82,765,397)	(82,761,729)
Cash flows from noncapital and related financing activities:		
Federal operating and preventive maintenance assistance	2,895,812	16,057,570
State operating grants	39,227,799	38,566,284
Local contributions	47,273,658	48,986,462
Other revenues	726	24,520
Net cash provided by noncapital and related financing activities	89,397,995	103,634,836
Cash flows from capital and related financing activities:		
Capital grants received	5,681,869	7,375,702
Purchase of capital assets	(4,080,369)	(7,709,634)
Proceeds from installment note	144,239	—
Payment on installment note payable	(7,080,483)	(5,980,025)
Interest paid	(3,657,251)	(2,994,300)
Net cash used in capital and related financing activities	(8,991,995)	(9,308,257)
Cash flows from investing activities:		
Interest received	342,250	255,310
Net cash provided by investing activities	342,250	255,310
Net increase (decrease) in cash and cash equivalents	(2,017,147)	11,820,160
Cash and cash equivalents, beginning of year	20,593,637	8,773,477
Cash and cash equivalents, end of year	$ 18,576,490	20,593,637
Noncash activities:		
Loss on retirement of assets	$ 2,400,990	3,262,454
Assets acquired on installment plan	—	23,397,297

(Continued)

SUBURBAN MOBILITY AUTHORITY FOR REGIONAL TRANSPORTATION

Statements of Cash Flows

Years ended June 30, 2004 and 2003

	2004	2003 (As restated)
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$ (100,857,576)	(96,094,658)
Adjustments to reconcile to net cash used in operating activities:		
Depreciation expense	15,985,992	13,714,094
Change in assets and liabilities:		
Decrease (increase) in operating assistance due from the State of Michigan	358,637	(314,708)
Decrease in other receivables	258,307	454,641
Decrease (increase) in materials and supplies	901,095	(182,269)
Increase in prepaid expenses	(91,496)	(705,883)
(Decrease) increase in municipal and community credits payable	396,125	(959,496)
Increase in amounts payable under purchase-of-service agreements	157,452	13,624
Increase in accrued self-insurance	1,402,549	267,041
(Decrease) increase in payable to the State of Michigan	(76,331)	47,021
(Decrease) increase in accounts payable and accrued expenses	(1,144,783)	1,297,983
Decrease in net pension obligation	(551,056)	(906,846)
Increase in accrued compensation	495,688	607,727
Net cash used in operating activities	$ (82,765,397)	(82,761,729)

See accompanying notes to financial statements.

(1) Description of Operations and the Entity

(a) Organization

Suburban Mobility Authority for Regional Transportation (SMART or the Authority), an instrumentality of the State of Michigan, is a public benefit agency created pursuant to the provisions of Act No. 204 of the Public Acts of Michigan of 1967, as amended. SMART is charged with the responsibility to plan, acquire, construct, operate, maintain, replace, improve, extend, and contract for public transportation facilities within the counties of Macomb, Oakland, and Wayne. SMART is managed by a seven-member board of directors, who represent the counties that comprise SMART's operating region.

In August 2002, voters in Macomb County and in those communities participating in Act 196 Transportation Authorities in Oakland County and Wayne County approved a four-year, 6/10-mill property tax dedicated to public transportation. Tax revenues received by Macomb County, the Wayne County Act 196 Authority, and the Oakland County Act 196 Authority and contributed to SMART for the years ended June 30, 2004 and 2003 were $47,625,635 and $46,242,794, respectively.

Pursuant to the provisions of legislation enacted in 1988 which amended Act No. 204, a corporation known as the Regional Transit Coordinating Council (RTCC) is the designated recipient of operating assistance funds from the State of Michigan and the Federal Transit Administration (FTA). SMART and the Detroit Department of Transportation (DDOT) are subrecipients of such operating assistance funds. The Articles of Incorporation of RTCC provide that 35% of any state or federal transportation operating assistance or formula capital grants or loans is to be distributed to SMART, and the remaining 65% is to be distributed to DDOT. FTA and the State of Michigan pay such funds directly to SMART and DDOT at the direction of RTCC. Capital grants or loans – which are not allocated on a formula basis by the responsible federal or state agencies but, rather, are allocated on a specific project or asset basis – are allocated to SMART and DDOT based on the terms of the grant or loan.

(b) Reporting Entity

For financial reporting purposes, all departments and operations over which SMART exercises oversight responsibility are included in the reporting entity. Oversight responsibility was evaluated based on consideration of financial interdependency, selection of governing authority, designation of management, the ability to significantly influence management, and accountability for fiscal matters.

No governmental units other than SMART itself are included in the reporting entity. SMART does not have oversight responsibility over any other governmental unit. This is evidenced by the fact that, with respect to any other governmental unit, including the transportation agencies with which SMART has entered into purchase-of-service agreements (see note 7), or the Act 196 Transportation Authorities in the counties served by SMART, SMART does not select their governing authority, designate their management, exercise significant influence over their daily operations, or maintain their accounting records.

SMART is not included within the reporting entity of the State of Michigan, because the State has no authority to appoint or remove SMART's management or board of directors and is not accountable for its fiscal matters.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The accounts of the Authority, which are organized as an Enterprise fund, are used to account for the Authority's activities that are financed and operated in a manner similar to a private business enterprise. Accordingly, the Authority maintains its records on the accrual basis of accounting using the economic resources measurement focus. Revenues from operations, investments, and other sources are recorded when earned. Expenses (including depreciation and amortization) of providing services to the public are accrued when incurred.

Nonexchange transactions, in which SMART receives value without directly giving equal value in return, include federal operating and preventative maintenance assistance, state operating grants, local contributions from property taxes, and capital contributions. On an accrual basis, revenue from these grants and contributions is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when use is first permitted, and expenditure requirements, in which the resources are provided to SMART on a reimbursement basis.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* the Authority applies all applicable GASB pronouncements, as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures – an Amendment of GASB Statement No. 3*. The provisions of this Statement are effective for fiscal periods beginning after June 15, 2004. SMART has not yet determined the effect, if any, GASB Statement No. 40 will have on its financial statements.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The provisions of this Statement are effective for fiscal periods beginning after December 15, 2004. SMART has not yet determined the effect, if any, GASB Statement No. 42 will have on its financial statements.

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The provisions of this Statement are effective for fiscal periods beginning after December 15, 2006. SMART has not yet determined the effect, if any, GASB Statement No. 45 will have on its financial statements.

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(b) ***Cash and Cash Equivalents***

Cash and cash equivalents consist of cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

(c) ***Materials and Supplies***

Materials and supplies consist of repair parts for buses and operating supplies and are valued at the lower of cost or market, with cost determined on an average-cost basis.

(d) ***Capital Assets***

Capital assets are defined by the Authority as assets with an initial individual cost of more than $2,500 ($1,000 for computer equipment) and an estimated useful life in excess of a year. Purchased or constructed capital assets are reported at cost or estimated historical cost. Improvements, which extend the useful lives of the assets, are capitalized. Donated fixed assets are recorded at their estimated fair value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Depreciation is computed using the straight-line method, based upon the estimated useful lives of the assets as follows:

Buildings	25 years
Linehaul buses	7 – 12 years
Community transit buses	4 – 7 years
Equipment and office furniture	3 – 10 years

Leasehold improvements are amortized over the shorter of the life of the improvement or the life of the related lease.

(e) ***Claims Expense***

Claims expense is accrued in the period that incidents of loss occur, based upon estimates of liability made by management with the assistance of third-party administrators, legal counsel, and actuaries. Claims liability represents management's best estimate based on known information.

(f) ***Compensated Absences***

SMART employees earn vacation and sick leave, which is generally fully vested when earned. Unused vacation time may be carried over to the following year with certain limitations; upon termination of employment, employees are paid for unused accumulated vacation. With certain limitations, sick leave may be accumulated and paid upon retirement and, for certain employees, upon voluntary termination of employment. For certain employees, some accumulated sick leave may also be converted into additional vacation time. Accumulated unpaid vacation and sick leave are recorded as a liability.

(g) Capital Acquisition Grant Activities

Federal and state capital acquisition grants fund the purchase of capital items, including buses, bus terminals, and related transportation equipment used by SMART and other transit agencies within the southeastern Michigan region. Capital grants for the acquisition of capital assets are recorded as grants receivable in the statement of net assets and capital contributions in the statement of revenues, expenses, and changes in net assets when the related qualified expenditures are incurred. When capital assets relating to other transit agencies are transferred to such transit agencies, their related costs are removed from the records of SMART.

When assets acquired with capital grant funds are disposed of, the Authority is required to notify the granting federal agency. A proportional amount of the proceeds or fair market value, if any, of such property may be used to acquire like-kind replacement vehicles or remitted to the granting federal agency.

(h) Net Assets

Equity is displayed in three components as follows:

- *Invested in capital, net of related debt* – This consists of capital assets, net of accumulated depreciation, less the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- *Restricted* – This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the Authority's policy to use restricted resources first and then unrestricted resources when they are needed. The Authority does not have restricted net assets at June 30, 2004 or 2003.
- *Unrestricted* – This consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

(i) Classification of Revenues

SMART has classified its revenues as either operating or nonoperating revenues according to the following criteria:

- *Operating revenues* – Operating revenues include activities that have the characteristics of exchange transactions, such as revenues from transit operations.
- *Nonoperating revenues* – Nonoperating revenues include activities that have the characteristics of nonexchange transactions that are defined as nonoperating revenues by GASB No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,* and GASB No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,* such as federal and state contributions and investment income.

(j) *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(k) ***Reclassifications***

Certain amounts from the prior year have been reclassified to conform to the current year presentation.

(3) State of Michigan Operating Assistance Funds

Under Act 51 of the Public Acts of 1951, as amended, the State of Michigan makes distributions of funds that have been appropriated for mass transit operating assistance. RTCC is the designated recipient of such funds, and SMART is a subrecipient of RTCC. SMART has recorded operating grant revenues under Act 51 based on a formula that takes into account the eligible costs incurred by SMART, estimates of eligible costs incurred by DDOT, locally generated revenues of SMART and DDOT, the percentage of RTCC's funding that is allocable to SMART, and preliminary information made available by the Michigan Department of Transportation (MDOT) as to the amount of funds expected to be available to the RTCC. Table 1 below includes total Act 51 revenue received by SMART and the percentage of the state funded portion of the eligible costs for the current year and six prior years. The Act 51 revenue includes urban, non-urban, municipal credits, and adjustments.

Supplementary Information – Table 1

	Act 51 revenue	State's % of eligible costs
Fiscal year ended June 30:		
1998	$ 36,342,399	50.00%
1999	36,210,856	43.00%
2000	33,948,040	39.76%
2001	33,539,932	37.06%
2002	33,692,498	38.08%
2003	34,496,055	35.60%
2004	35,041,975	35.20%

Based on the latest available determinations of State operating assistance allocable to SMART in accordance with the Act 51 funding formula, for certain of the State's fiscal years through September 30, 2003, operating assistance payments were received in excess of the amounts allocable to SMART. The overpayments, in the amount of $9,248 and $85,579, are recorded as a payable to the State of Michigan at June 30, 2004 and 2003, respectively.

Act 51 requires SMART to provide a portion of the State operating assistance as funding to municipalities within its transportation district. Amounts not used by the municipalities within two years must be expended by SMART for operating purposes within the county in which the city, village, or township lies. SMART was required to provide approximately $3,059,000 pursuant to this provision in both fiscal years 2004 and 2003.

(4) Cash and Cash Equivalents

SMART has deposits with various financial institutions. At June 30, 2004 and 2003, the carrying amount of SMART's deposits was $18,576,490 and $20,593,637, respectively, and the bank balance was $18,945,533 and $21,194,538, respectively. The difference in carrying amount and the bank balance is due to items in transit and outstanding checks. Of the bank balances, $300,000 was covered by federal depository insurance and the remainder was uncollateralized. Michigan law does not require collateralization of government deposits.

(5) Grants Receivable

At June 30, grants receivable are comprised of the following:

	2004	2003
Accounts receivable, billed:		
Federal Operating Grant (CMAQ)	$ 1,223,244	2,058,574
Federal government grants	12,880,465	617,562
State of Michigan grants	3,476,826	2,998,459
Total billed	17,580,535	5,674,595
Accounts receivable, unbilled:		
Federal government grants	357,049	1,873,438
State of Michigan grants	1,871,004	1,513,646
Local grants	80,996	64,985
Total unbilled	2,309,049	3,452,069
Total	$ 19,889,584	9,126,664

(Continued)

(6) Capital Assets

Capital asset activity during the fiscal year ended June 30, 2004 is as follows:

	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Capital assets not being depreciated:				
Land	$ 4,246,270	—	—	4,246,270
Construction in progress	21,018,217	256,607	21,018,217	256,607
Total capital assets not being depreciated	25,264,487	256,607	21,018,217	4,502,877
Capital assets being depreciated:				
Linehaul buses and equipment	83,481,499	20,413,374	12,530,169	91,364,704
Community transit buses and related equipment	25,162,119	560,664	275,715	25,447,068
Buildings	35,870,096	2,410,224	—	38,280,320
Office furniture and equipment	1,801,873	1,971	—	1,803,844
Other equipment	35,643,231	1,017,460	—	36,660,691
Leasehold improvements	2,809,068	473,089	—	3,282,157
Total capital assets being depreciated	184,767,886	24,876,782	12,805,884	196,838,784
Less accumulated depreciation and amortization:				
Linehaul buses and equipment	26,307,771	8,081,290	10,102,583	24,286,478
Community transit buses and related equipment	15,735,551	2,880,408	267,508	18,348,451
Buildings	23,900,782	1,134,323	—	25,035,105
Office furniture and equipment	1,662,713	24,010	—	1,686,723
Other equipment	24,703,449	3,708,436	—	28,411,885
Leasehold improvements	1,818,966	157,525	—	1,976,491
Total accumulated depreciation	94,129,232	15,985,992	10,370,091	99,745,133
Total capital assets being depreciated, net	90,638,654	8,890,790	2,435,793	97,093,651
Total capital assets, net	$ 115,903,141	9,147,397	23,454,010	101,596,528

Capital asset activity during the fiscal year ended June 30, 2003 is as follows:

	Balance July 1, 2002	Additions	Deletions	Balance June 30, 2003
Capital assets not being depreciated:				
Land	$ 4,246,270	—	—	4,246,270
Construction in progress	26,846,415	21,018,217	26,846,415	21,018,217
Total capital assets not being depreciated	31,092,685	21,018,217	26,846,415	25,264,487
Capital assets being depreciated:				
Linehaul buses and equipment	74,750,779	30,028,348	21,297,628	83,481,499
Community transit buses and related equipment	21,936,007	4,233,344	1,007,232	25,162,119
Buildings	35,327,578	542,518	—	35,870,096
Office furniture and equipment	1,768,180	33,693	—	1,801,873
Other equipment	33,749,308	1,921,287	27,364	35,643,231
Leasehold improvements	2,583,621	225,447	—	2,809,068
Total capital assets being depreciated	170,115,473	36,984,637	22,332,224	184,767,886
Less accumulated depreciation and amortization:				
Linehaul buses and equipment	37,974,787	6,384,122	18,051,138	26,307,771
Community transit buses and related equipment	14,030,659	2,677,707	972,815	15,735,551
Buildings	22,748,131	1,152,651	—	23,900,782
Office furniture and equipment	1,638,739	23,974	—	1,662,713
Other equipment	21,352,974	3,350,475	—	24,703,449
Leasehold improvements	1,693,802	125,164	—	1,818,966
Total accumulated depreciation	99,439,092	13,714,093	19,023,953	94,129,232
Total capital assets being depreciated, net	70,676,381	23,270,544	3,308,271	90,638,654
Total capital assets, net	$ 101,769,066	44,288,761	30,154,686	115,903,141

(7) Purchase-of-service Agreements

SMART has entered into purchase-of-service agreements with various transportation agencies, including community transit operators, all of which are separate transit systems operating in SMART's region. The agreements generally require that operating losses (as defined in the respective agreements) of these transportation agencies be subsidized up to specified maximum amounts.

Expenses under the purchase-of-service agreements for the years ended June 30 are comprised of the following:

		2004	2003
Municipal credits	$	3,058,956	3,058,956
Community credits		2,945,747	2,945,747
Community transit bus service		1,859,915	1,840,516
Specialized services		710,486	750,305
Ridesharing		103,271	96,329
NOTA		49,473	48,412
New services		44,150	25,807
Community-based services		90,813	49,991
Total	$	8,862,811	8,816,063

(8) Self-insured Liabilities

In fiscal 2004 and 2003, SMART was self-insured for vehicle and general liability claims up to $1 million per occurrence, and is insured for losses in excess of such amount up to $1 million per occurrence and $10 million in the aggregate. SMART also was self-insured for workers' compensation claims up to $500,000 per specific claim, and is insured up to $5 million for aggregate losses in excess of $500,000 per claim. Vehicle and general liability and workers' compensation claim liabilities are actuarially determined based on known information. Liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. These liabilities are classified as current, although some portion may not be paid within one year. Management believes, based on prior experience, that the estimated reserve for claims is adequate to satisfy all claims filed, or to be filed, for incidents that occurred through June 30, 2004.

Settled claims have not exceeded commercial coverage in any of the preceding three years.

SMART carries commercial insurance for other areas of risk, including health benefits.

Changes in the balances of self-insured liabilities during fiscal 2004 and 2003 were as follows:

		2004	2003
Claims liability – July 1	$	10,705,640	10,438,599
Current year claims		4,674,603	5,793,059
Claim payments		(3,272,054)	(5,526,018)
Claims liability – June 30	$	12,108,189	10,705,640

(9) Notes Payable

On September 8, 2000, SMART entered into an installment purchase contract to acquire 100 transit coaches during fiscal year 2001 at a cost of $27.3 million. The acquisition is financed at a 5.23% interest rate over a 10-year period, with a semi-annual payment of principal and interest of $1.77 million, each due on February 15 and August 15 of each year. The contract also provides for two annual options to acquire 100 and 87 additional coaches during fiscal years 2002 and 2003, respectively, at interest rates indexed to the market. At June 30, 2003, all 100 buses were delivered.

In August 2001, SMART exercised its option to get 100 additional buses. This acquisition is financed at a 4.90% rate over a 10-year period, with semi-annual payment of principal and interest of $1.9 million, each due on February 15 and August 15 of each year.

In October 2002, SMART exercised its option to acquire the final 87 buses. The acquisition is financed at a 4.70% rate over a 10-year period, with semi-annual payment of principal and interest of $1.6 million, each due on February 15 and August 15 of each year. These three contracts are recorded as notes payable in the financial statements.

Subsequent to the acquisition of the first 100 transit coaches (IPS#1), a significant downward fluctuation in the capital market interest rates occurred. The decrease in market rates was sufficient to warrant a restructuring of IPS#1 with a reduction in interest expense to SMART. Effective February 18, 2004, the new interest rate for IPS#1 is 4.44%, with a semi-annual payment of principal and interest of $1.74 million. The restructuring of IPS#1 will reduce interest expense by over $425,000 over the life of the note.

Note payable activity for the year ended June 30, 2004 was as follows:

Issue	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004	Due within one year
Note 1	$ 21,712,695	144,239	2,432,878	19,424,056	2,646,607
Note 2	23,238,506	—	2,555,005	20,683,501	2,681,732
Note 3	22,161,997	—	2,092,600	20,069,397	2,193,822
Total	$ 67,113,198	144,239	7,080,483	60,176,954	7,522,161

Note payable activity for the year ended June 30, 2003 was as follows:

Issue	Balance July 1, 2002	Additions	Deletions	Balance June 30, 2003	Due within one year
Note 1	$ 24,023,157	—	2,310,462	21,712,695	2,432,879
Note 2	25,672,769	—	2,434,263	23,238,506	2,555,004
Note 3	—	23,397,297	1,235,300	22,161,997	2,092,600
Total	$ 49,695,926	23,397,297	5,980,025	67,113,198	7,080,483

(Continued)

As of June 30, 2004, the annual requirements to pay principal and interest on the notes are as follows:

		Principal	Interest	Total
Year ended June 30:				
2005	$	7,522,161	2,997,496	10,519,657
2006		7,871,654	2,648,003	10,519,657
2007		8,246,285	2,273,372	10,519,657
2008		8,638,778	1,880,879	10,519,657
2009 and thereafter		27,898,076	3,364,860	31,262,936
2010 and thereafter		—	—	—
Total	$	60,176,954	13,164,610	73,341,564

(10) Pensions

(a) Plan Description

SMART participates in the Municipal Employees' Retirement System (MERS) of Michigan. MERS is an agent multiple-employer, statewide public employee defined-benefit pension plan created under Public Act 135 of 1945, now operating under Public Act 220 of 1996. MERS was established to provide retirement, survivor, and disability benefits on a voluntary basis to the State of Michigan's local government employees.

Pursuant to Act 220, on August 15, 1996, MERS became an independent public nonprofit corporation, which is an instrumentality of the participating municipalities and courts. Prior to that, MERS was a component unit of the State of Michigan and operated within the Department of Management and Budget. MERS is administered solely by a Retirement Board. Benefit programs and provisions are established by the Retirement Board. MERS assigns the authority to establish and amend the benefit provisions of the plan to the respective employer entities. MERS of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to Municipal Employees' Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan, 48917 or by calling 1-800-767-6377.

Substantially all SMART employees are members of the MERS plan. As of December 31, 2003, the date of the last actuarial valuation, 362 retirees and beneficiaries were receiving benefit payments, and the Plan had 993 active members and 149 inactive vested members.

Benefits vest after 6 years of service, with special provisions for death and disability. Normal retirement is at age 60 with 6 years of service or at age 55 with 15 years of service. Early retirement with reduced benefits is available beginning at age 50 with 25 years of service.

(b) ***Funding Policy***

Members of only one of SMART's collective bargaining units make contributions to MERS. For the years ended June 30, 2004 and 2003, such employees contributed 3% of their payroll. SMART is required to contribute at an actuarially determined rate. For the fiscal year ended June 30, 2004, the rates, as a percentage of annual payroll, are as follows: ATU drivers, 10.87%; ATU clerical, 10.88%; UAW #771, 7.85%; Teamsters #247, 13.09%; AFSCME 1917, 15.77%; nonunion, 13.49%. The contribution requirements of plan members are established and may be amended by the Retirement Board of MERS.

(c) ***Annual Pension Cost***

For fiscal years ended June 30, 2004 and 2003, SMART recorded annual pension expense of $4,370,713 and $4,527,535, respectively.

The required contribution amount was determined as part of the December 31, 2001 actuarial valuation using the entry-age normal cost actuarial method. The actuarial assumptions included: (a) 8% investment rate of return; (b) projected salary increase of 4.5% per year compounded annually, attributable to inflation; (c) additional projected salary increases of 0.0% to 4.2% per year, depending on age, attributable to seniority/merit; and (d) the assumption that benefits will increase 2.5% per year (annually) after retirement for pensions under certain categories. The actuarial values of assets are determined on the basis of a valuation method that assumes the fund earns the expected rate of return (8%) and includes an adjustment to reflect market value. SMART's unfunded actuarial accrued liability is being amortized as a level percent of payroll over a period of 30 years.

In order to conform with accounting principles generally accepted in the United States of America, SMART changed its method for recording annual pension expense and net pension obligation during fiscal year 2004. This has resulted in a restatement of SMART's financial statements for the year ended June 30, 2003. The effects of the restatement to the 2003 financial statements are summarized as follows:

Account description		As previously stated	Adjustments	As restated
Net assets at July 1, 2002	$	53,462,047	(1,507,131)	51,954,916
Fringe benefits expense		20,483,854	(906,846)	19,577,008
Net pension obligation		—	600,285	600,285
Net assets at June 30, 2003		57,998,755	(600,285)	57,398,470

SMART's annual pension cost and net pension obligations for the years ended June 30, 2004 and 2003 are as follows:

		2004	2003
Annual required contributions	$	4,354,884	4,497,705
Interest on net pension cost		48,023	120,571
Adjustment to annual required contribution		(32,194)	(90,741)
Annual pension cost		4,370,713	4,527,535
Contributions made		4,921,769	5,434,381
Decrease in net pension obligations		(551,056)	(906,846)
Pension obligation at the beginning of the year		600,285	1,507,131
Pension obligation at the end of the year	$	49,229	600,285

- *Three-year Historical Trend Information (dollar amounts in thousands):*

Fiscal year ended June 30:		Annual pension cost (APC)	Percentage of APC contributed		Net pension obligation
2002	$	2,727	142%	$	1,507
2003		4,528	120%		600
2004		4,371	113%		49

Required Supplementary Information (Unaudited)

- *Analysis of Funding Progress (dollar amounts in thousands):*

Valuation date December 31		Actuarial value of assets (a)	Actuarial accrued liability (AAL) – entry age (b)	Unfunded AAL (UAAL) (b)-(a)	Funded ratio (a)/(b)		Annual covered payroll (c)	UAAL as a percentage of covered payroll (b)-(a)/(c)
2001	$	90,768	107,802	17,034	84.20%	$	38,372	44%
2002		95,739	115,645	19,906	82.79%		38,729	51%
2003		105,865	126,425	20,560	83.74%		39,568	52%

(Continued)

(11) Other Postretirement Benefits

In addition to the pension benefits described in note 10, SMART provides postretirement health insurance, life insurance, and prescription benefits to certain employees who retire after attaining age 60 with at least 6 years of service or after attaining age 55 with at least 15 years of service. For the years ended June 30, 2004 and 2003, approximately 221 and 243 retirees met those eligibility requirements. Expenses for health and life insurance are recognized monthly as premiums are paid. Expenses for prescriptions are recognized as retirees file claims. Expenses for such postretirement benefits for the years ended June 30, 2004 and 2003 were approximately $1,895,786 and $1,723,172, respectively.

(12) Commitments

SMART leases certain office space and equipment under operating lease agreements. Some leases include escalation clauses for SMART's pro-rata share of taxes and operating expenses. Most leases of office space and equipment are on a month-to-month basis. Total rent expense for the years ended June 30, 2004 and 2003 was approximately $506,793 and $494,791, respectively. SMART entered into a noncancelable lease commencing February 1, 2002 through January 31, 2005 for office space for its administrative office personnel and for a ticket sales store. The monthly rental payment on this lease is $30,892. Future lease payments are $362,000 and $362,000 for fiscal years ended June 30, 2005 and 2006, respectively.

(13) Contingencies

Various legal actions and workers' compensation claims are outstanding or may be instituted or asserted against SMART. Management has accrued amounts with respect to such actions and claims based on its best estimate of SMART's ultimate liability in these matters, including an estimate for claims that have been incurred but not reported for self-insured vehicle liability (see note 8).

(14) Deferred Compensation Plan

SMART offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan permits employees to defer a portion of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plan are held for the exclusive benefit of the participants and their beneficiaries and are not reflected in SMART's financial statements.